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DRAFT of 9 Jan 1964

DCI SPECIAL BRIEFING  
ON SOVIET ECONOMY

INTRODUCTION

- I. I am particularly anxious to discuss the state of the Soviet economy today because it is our belief that the Kremlin is facing one of its most serious dilemmas of the post-war years and hopes to solve it with Western help.
- A. The broad outlines of this dilemma have appeared in the public print:
1. the growth rate of the Soviet economy has fallen off sharply;
  2. critical resources are insufficient to support both an arms race and any substantial growth of the civilian economy;
  3. essential grain imports have strained Soviet gold reserves; and
  4. Khrushchev must obtain major plants, equipment, and other imports from the industrial West.
- B. I do not believe, however, that this public version accurately measures the severity of the Soviet economic crisis as we see it in our intelligence analysis.

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1. It is not generally accepted, for example, that the growth rate of the Soviet economy in fact fell below 2.5 percent in 1962 and 1963.

C. I feel we need to use every available intelligence tool to determine just how desperate Khrushchev may be when he comes to us for help.

D. Let me begin by saying that we in the US intelligence community have a high degree of confidence in our present estimates of the Soviet military and economic position. These estimates rest on a base of evidence which is broader and more solid than any we have had before.

1. The evidence comes from a wide variety of sources,

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2. While economic secrets may seem somewhat less vulnerable to some of these methods than are the targets for military intelligence, the severity of the economic situation makes it harder for the Soviets to maintain secrecy about their economy.

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### THE SOVIET ECONOMY

- I. Khrushchev today must find little to please him when he surveys the state of the Soviet economy.
  - A. The economy has in effect had a threefold assignment: supporting an aggressive foreign policy, including the arms and space races; catching up with the US in industrial output; and raising the level of consumption of the Soviet people. The growth rate of the economy, however, has not measured up to these tasks.
    1. The developing difficulties of the economy now have been brought to a head by the disastrous harvest of 1963.
  - B. The first four years of Khrushchev's leadership, through 1959, were a great success. The New Lands and corn programs gave agriculture its first real lift since 1937.
    1. Economic growth in this period was made easier by a reduction in military spending and in armed forces manpower in 1956 and 1957.
    2. This was the period when Khrushchev began making those promises about catching up with the United States in meat, milk, consumer goods and industrial production.

C. Since 1959, however, the economy has slowed down significantly. Difficulties appeared not only in agriculture, but in all parts of the economy.

1. Industrial growth slowed down.
2. More ominously for Soviet prospects, investment growth began to slow drastically.

II. We think a large part of the blame for the slowdown falls on defense spending.

((Chart 1: Estimated and Announced Defense Expenditures, 1955-1963))

A. The first chart shows the trend in defense spending since 1955. The upper line is our estimate of actual defense expenditures.

1. After the decline in 1956 and 1957, spending started upward again in 1958, as missile systems emerged from the R&D phase into production and deployment.
2. We calculate that between 1958 and 1963, Soviet defense spending increased by more than one third.

B. The lower line on the chart is the defense budget announced by the Soviets.

1. The difference between the two lines is partly a question of coverage. The announced budget, for example, does not include atomic energy, or research and development.
2. There is also, however, an element of concealment. We estimate that total spending

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for military purposes began rising in 1958, while the announced budget showed no appreciable increase until 1961.

((Chart 2: Estimated Defense Spending by Type, 1956-1963))

C. The rise in defense spending came mainly in expenditures for development, procurement, and operation of equipment. The upper band on this chart shows expenditures which were primarily for personnel. You can see that they declined until 1961, and since then have remained nearly constant.

1. Conversely, the expenditures for procurement, R&D, and operations and maintenance have risen much faster since 1958 than the total defense spending.

D. The Soviet economic problem, however, lies less with the total defense spending than with the defense drain on the key critical resources of high-quality materials and manpower. Our estimates of the ruble cost of defense do not adequately reflect this factor of the quality of resources. A homely example may illustrate this point:

1. Military and civilian activities use many of the same types of trucks. When the finished trucks are inspected, those without defects go to the military. The civilian economy gets the others.

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2. The same rule applies to the top levels in manpower--the scientists, the engineers and technicians. Defense has first claim.

E. This military priority on critical resources stems particularly from the development of advanced weapons systems.

((Chart 3: Advanced Weapons Procurement))

1. This chart shows the portion of total procurement devoted to missiles, nuclear warheads and associated electronics.
2. "Conventional" procurement has declined, while the cost of advanced weapons has grown to two thirds of all procurement.
3. The rapid rise of these expensive programs is part of the reason for recent shortcomings in industrial investment, especially in the chemical industry.
4. The program for modernization and automation has also been hampered by lack of computers, which are monopolized by defense and research.

III. We estimate that Soviet military expenditures in 1963 amounted to just under 20 Billion new rubles or, if we calculate the dollar price of what the same package would cost in the United States, \$43.8 Billion. Here are our latest estimates of the military posture which creates this burden for the Soviet economy:

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A. As of October, there were 18 launch complexes for intercontinental missiles in the Soviet Union. They had more than 200 launching pads in various stages of construction. About 120 to 135 pads were operational.

((Graphic: Support Facility)) Each of these complexes requires, in addition to the actual firing positions, an extensive central support and storage facility.

B. As of October, we had listed about 675 sites in the Soviet Union for intermediate-range and medium-range ballistic missiles. Ninety percent of these sites are in the Western USSR from the Baltic to the Black Sea. Two thirds of them appear to be directed at Western European targets--200 toward the UK, and another 160 at West Germany and France.

C. Soviet Long Range Aviation has about 200 heavy bombers and tankers, and nearly 1,000 medium bombers

D. There are about 70 submarines built or refitted to fire ballistic and cruise missiles to a range of 300 to 350 nautical miles. While existing units carry only a few missiles and must surface to fire, the evidence suggests that a weapons system for submerged launch of a 700-mile ballistic missile could be operational in the near future.

E. We estimate Soviet ground forces at 1.6 to 1.8 million men, organized in 110 to 140 divisions. Only about half of these are at combat strength; the rest would need to be built up by mobilization before being committed to action.

1. Even at combat strength, Soviet divisions and armies are considerably smaller than US counterparts. We also believe that the non-divisional support the Soviets maintain in peacetime is short of wartime needs.
2. The European satellites, excluding Albania, have 940,000 men in some 62 divisions. About half of these could be militarily effective in conjunction with Soviet forces, although their political reliability may be uncertain.
3. The Soviets have 22 combat-strength divisions and some 1,200 tactical aircraft in East Germany and Poland. They would probably want to build up a considerably larger force before launching any campaign against Western Europe. We estimate that by including 5 to 15 satellite divisions, they could assemble 50 to 60 divisions and 2,000 aircraft in about 30 days.

F. The principal center for Soviet research on the anti-ballistic missile is a range of 8,500 square miles near Sary Shagan in Central Asia. More than 300 missiles have been fired into this range in the past six years. We are almost certain that some missiles have been fired at the incoming ones by Sary Shagan in attempted intercepts.

((Photo, Leningrad ABM))

1. An installation near Leningrad is believed to be an ABM system under construction. It is probably meant to engage both intercontinental and intermediate missiles. The apparent lines of fire

((Drawing, Leningrad ABM)) are roughly reciprocal to the probable

course of missiles fired at Leningrad from Western facilities.

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2. We have reason to know the enormous end cost of an effective and reliable anti-missile system, and we do not believe the Soviet leaders will order any wide deployment until they have something more effective and reliable than what we know of to date.

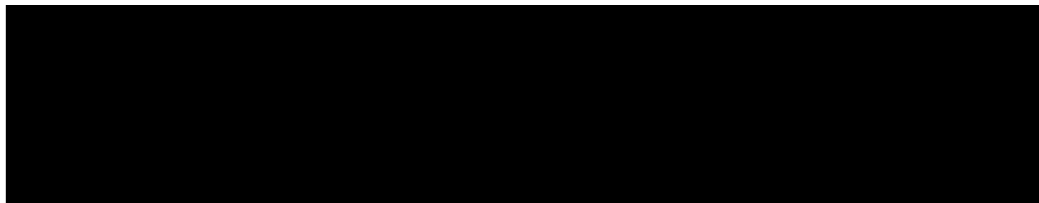
G. We know of more than 900 sites in the Soviet Union and Eastern Europe for SA-2 surface-to-air missiles of the type deployed to Cuba. The Soviets have also deployed about 80 sites for the SA-3, a new system designed for more effective engagement of low-flying targets. Surface-to-air sites already defend nearly all of the 100 Soviet cities with 200,000 or more residents.

1. The Soviets carry about 4,500 fighter aircraft in air defense units. Only about one third have all-weather capability.

2. Nevertheless the significant improvement of the Soviet air defense will progressively reduce the chances for successful attack by manned bombers, except with increasingly sophisticated systems of attack.

H. The Soviets have a large military atomic energy program for the production of fissionable materials; the development, production and deployment of nuclear weapons; and nuclear propulsion for submarines.

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2. Soviet nuclear weapon technology is highly developed. There were about 40 tests between 1949 and 1958, and more than 100 in 1961 and 1962 after the intervening test moratorium. The later series included thermonuclear devices with very high yields, [REDACTED] Nuclear weapons have been stockpiled throughout the USSR for Long Range Aviation and the Strategic Missile Forces, and to a lesser extent for Tactical Air, Air Defense, and ground forces.
3. The USSR has more than 30 submarines with nuclear propulsion in service, and is adding about 10 units a year.

((Chart 4: Comparative Annual Growth of US and Soviet GNP))

- IV. The cost of this defense establishment--particularly the advanced weapons--and the primacy of defense over the civilian economy for investment and resources have had a marked effect on the overall growth of the Soviet economy. During the 1950's, Soviet Gross National Product grew at an average of about 6 percent per year--roughly twice as fast as that of the United States.
- A. In the 1960's, however, the rate of growth has fallen off, and for the past two years it has been less than 2.5 percent, and below the rate in the US.

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B. Much of the wide fluctuation in the annual rates of growth in the USSR reflects the fortunes of Soviet agriculture.

1. For instance, 1956, 1958, and 1961 were years of good harvests.
2. But 1962 was a bad year, and 1963 was a near disaster.
3. Thus, if the weather is average next year, the harvest might be expected to put the GNP figure back to a growth of 4 to 5 percent.

C. All of the slowdown was not accounted for by agriculture, of course. Investment and industry also slowed down.

((Chart 5: Growth Rate of Investment and Defense))

1. In this chart, we can see the surge of new Fixed Investment growth in 1956 to 1959.
2. Then the resumption of growth in defense spending, in 1958 and 1959, was followed by a slowdown in investment to about 4 to 5 percent in 1961 to 1963. Even industrial investment, which had been growing at about 12 percent, fell off to about 4 to 5 percent at this time.

((Chart 6: Total, Civilian, and Military Industrial Production))

D. We can see the same competition between civilian and military users within industrial production.

1. Once again, this chart shows the civilian share of production growing rapidly in the early years, and slowing down in the later years.
2. The pattern of production of equipment--including arms--for the military is just the reverse.
3. Meanwhile, the growth rate for total industrial production has dropped off from 8 to 9 percent to a current rate of 6 to 7 percent.

V.. In spite of recent difficulties, the Soviet Union has created a formidable defense establishment. This has been achieved by decades of priorities and concentration, first on industrial development, more recently on advanced weapons development.

((Chart 7: Comparative Total US and Soviet GNP and Components))

A. This chart of the end uses of total output in the Soviet Union and the United States shows the pattern of how the Soviets concentrate their resources.

1. Total Soviet GNP in 1962 was less than half that of the United States.
2. Soviet consumption was little more than one third of US consumption--even less on a per capita basis.
3. Total Soviet investment, on the other hand, was fairly close to the US in absolute terms. Furthermore, in comparison to the corresponding figures in the United States, investment in industry was much larger both in percent and in absolute terms.

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Other than industry, the rest of total investment goes into such items as highways or commercial and housing construction, in which the Soviets are considerably less interested than is the West.

4. Education, on the other hand, is something the Soviets look upon as an investment in productive labor. Hence the Soviet educational effort, out of half as large a GNP, amounts to more than two thirds of ours.
5. Finally, the Soviet defense effort--measured in US prices and costs--was four fifths that of the United States. I must add, however, that whether you calculate in rubles, or in equivalent dollar figures, there are always factors which tend to make these comparisons misleading to some degree.

VI. The end uses shown on the last chart do not include Soviet military and economic aid programs. In addition to helping its satellites, the Soviet Union has given economic aid to some 25 non-Communist underdeveloped countries, and military assistance on liberal credit terms to 13.

- A. From 1954 through 1959, new extensions of economic aid to non-Communist countries tended to increase each year, exceeding \$800 million in 1959. The USSR seems to have tightened its criteria for such aid in 1960 and 1961.

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1. By 1962, the figure was down to a low of \$77 million. We estimate that last year it amounted to about \$200 million.
  2. During the past two years new commitments for Soviet military assistance outside the bloc have also been cut back. Deliveries, however, are maintaining a high pace, and new requests are being met.
- B. Despite this recent retrenchment in Soviet economic and military aid, the drawings against past commitments are increasing.
1. Total economic and military commitments to date outside the bloc are about \$6.1 Billion.
    - a) Of this, more than \$2 Billion in economic aid remains to be drawn.
    - b) There is also as much as \$1 Billion outstanding in military commitments, but this probably will be covered largely by delivery of obsolescent equipment.
- C. Soviet economic aid to Communist countries--including Cuba and Yugoslavia--has amounted to more than \$4.6 Billion over the past decade. It fluctuates widely from year to year.
1. The value of Soviet military assistance to Communist countries is difficult to measure on the basis of available information. It includes an estimated \$500 million for Cuba in the ~~past four~~ years.

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D. In spite of the general economic slowdown, the reduced level of new foreign aid commitments probably does not stem from any inability to spare the moderate amounts involved.

1. Instead, we think that past experience now has led the Kremlin to take a less enthusiastic view of whether generosity to underdeveloped countries will pay off in political gains.
2. There are also, of course, political and psychological inhibitions against granting large-scale foreign assistance at a time when some domestic programs are being curtailed.

((Chart 8: US and Soviet Population and Employment))

VII. Before I turn to the specific subject of agriculture, I want to mention the related factors of assignment of manpower, and the Soviet diet.

- A. About 42 percent of the Soviet labor force is engaged in agriculture, but these 49 million people produce only about three quarters as much as the 6 million Americans engaged in agriculture.
- B. Soviet industry and US industry each employ just under a quarter of the labor force, but in the Soviet case this means half again as many workers for a much smaller output.
- C. The sectors squeezed in the USSR are trade and services.

((Chart 9: Composition of US and Soviet Diets.))

VIII. The composition of the Soviet diet is also significant

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- A. The average Russian gets almost as many calories as the average American--considerably more if you include the Soviet consumption of alcoholic beverages, which is about three times as high as in the United States.
  - 1. Only about a quarter of the Soviet diet, however, consists of the high-quality foods--livestock products, vegetables, fruit and the like.
  - 2. Grains and potatoes make up about 70 percent the Soviet diet, compared to about 30 percent of the American.
- B. A diet which is so heavily concentrated on grain magnifies the effects of a short grain crop.
  - 1. There is less feed grain for livestock. We already have considerable evidence of distress slaughtering.
  - 2. Customers are being limited to two loaves of bread per purchase, flour is disappearing from the stores, and factory cafeterias are either reducing or eliminating the free bread usually served with meals. Brown bread is being substituted for white. (The higher milling rate of the brown bread means that more of the cereal grain is used in bread, and less is left for animal feeding.)

IX. When the Communists first came to power in Russia, they inherited a generally favorable agricultural situation. Russian farms could produce enough food to leave a substantial surplus for export, paying for needed imports of machinery.



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- A. That surplus is no more. In the rush to develop heavy industry, agriculture was neglected in the distribution of investment funds

((Chart 10: Total and Per Capita Agricultural Production))

- B. Khrushchev's New Lands, half in Siberia and half in Kazachkstan, boosted lagging food production temporarily in the mid-1950's.

1. In 1956, production was already some 30 percent above 1953; by 1958, it was 50 percent higher.
2. As successive crops used up the original soil fertility and moisture of the new acreage, however, output fell off. Very little progress in total output was made from 1958 to 1962.
3. The severe 1963 drought, not only in the New Lands but in the traditional farming areas, reduced total output below 1958, and per capita production below 1956.

- B. As a result, the Soviet Union has had to become an importer of grain. To date, nearly 10 million tons have been contracted for, to be delivered before July.

- C. Khrushchev has launched a massive development program for the chemical industry, in an effort to solve the long-run problem of food and fiber supply as well as to modernize industry.

1. The program calls for tripling output of

chemicals by 1970

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2. The direct impact on the agricultural problem is to come from an increase in fertilizer production. The present 20-million-ton annual figure is to reach 70 to 80 million tons by 1970.
  3. Annual production of plastics is to rise from 600 thousand tons in 1963 to 3.5 to 4 million in 1970, and the present synthetic fiber output of 300,000 tons is supposed to be four to five times as great.
- D. If the program is carried out as planned, investment in the chemical industry will rise from 10 percent of industrial investment in 1963 to 18 percent in 1970.
1. Altogether Khrushchev wants 42 Billion rubles invested in the chemical program over the next seven years. At the official rate, this amounts to \$46 Billion. Frankly, we believe the program Khrushchev has outlined would call for a much greater investment than the equivalent of \$46 billion dollars.
  2. The Soviet Union has already been importing substantial quantities of chemical equipment. If Khrushchev's new goals are to be met, equipment imports from the West for the chemical program are going to have to amount to \$2 Billion or more---another substantial burden for gold stocks or export earnings.

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3. The domestic phase of the chemical program will increase the competition for high-grade personnel and resources being monopolized by the defense and space programs.
4. If the Soviet Union is able to buy first-rate equipment in the West, embodying the latest chemicals technology, that will go a long way toward helping the Soviet Union to complete this program without cutting too deeply into its defense needs.

X.. The combined need for grain and equipment imports has created a serious payments problem for the Soviet Union.

((Chart 11: Orientation of Soviet Foreign Trade))

- A. This chart shows that the largest part of Soviet trade is with the bloc. Trade with the industrial West has grown rapidly, however. This creates the payments problem, because the USSR has usually maintained an export surplus in over-all trade, but consistently runs a deficit in its trade with the West.

((Chart 12: Composition of Imports from the West))

- B. As this chart indicates, the largest and most rapidly growing portion of Soviet imports from the industrial West consists of machinery and equipment. This portion is of key significance for developing new industries such as synthetic fibers. It is also the portion partly financed by Western medium-term credits over the last few years.

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((Chart 13: Soviet Exports to the West))

C. Soviet exports to the West have also grown rapidly, but not as fast as imports. There is reason to believe that exports will increase considerably less rapidly in the future.

1. Petroleum has been the most rapidly rising export, but has leveled off over the past two years.
2. Marketing difficulties and a slower growth of exportable surplus make it appear unlikely that there will be another boom in POL exports in the future.

D. Even if the Soviet Union has moderate success in restoring grain production, the rising grain deficit in the satellites makes it improbable that the export of grain to the free world will resume in the foreseeable future.

1. The remaining exports--mainly wood products, metals, ores, and furs--may grow, but do not offer the prospect of rapid expansion.

E. The failure to generate enough exports to the West to cover rising import needs thus means an increasing trade deficit with the West.

((Chart 14: Soviet Hard Currency Payments Deficit))

This deficit, together with shipping charges and hard currency payments to the rest of the world, added up to a hard currency deficit of nearly \$1 Billion for the three years 1960 through 1962.

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- B. The deficit has been covered partly by gold sales, and partly--starting in 1959--by medium-term credits from the West. The credits shown on the chart are annual credit drawings, net of repayment and interest.
1. New credits have amounted to about \$300 million a year since 1961, but net credit has declined because of rising repayments and interest.
  2. If the Soviet Union should again get new credits of \$300 million in 1964, repayment and interest would absorb all but \$16 million.
- C. The payments deficits for 1963 and 1964 will be much larger than in 1962 because of the grain purchases. These are going to have to be financed largely by gold sales.

((Chart 15: Gold Production, Sales, and Stocks))

XI. On this chart you can see the steady reduction of the Soviet gold reserve as a result of the hard currency deficits.

- A. Production has grown slowly, reaching a peak of possibly \$175 million in 1963. We have evidence that it will be very difficult for the Soviets to achieve any substantial further increase.
- B. Sales, on the other hand, together with domestic use of some \$40 million a year, have substantially exceeded production since 1955.
- C. As a result, the reserve stock has dropped from nearly \$3 Billion in 1956 to \$1.8 Billion. Payment for grain already on contract--not including any

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D. With exports growing so slowly, and with gold stocks obviously approaching the minimum the Soviet Union must consider essential for emergencies, the only promising means of financing substantially larger imports of equipment is an expansion of credit, especially with longer repayment terms.

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THE SATELLITES

- I. The recent economic difficulties are not confined to the Soviet Union. Similar troubles have developed in all the bloc countries.
  - A. The entire Communist orbit experienced poor harvests in 1963. Thus Soviet purchases of grain in the West are competing with purchases by the European satellites--and by Communist China and North Vietnam as well--for the available supplies.
  - B. Industrial growth has slowed down in all of the European satellites except Rumania. This has been most pronounced in Poland and in the two most advanced satellites, Czechoslovakia and East Germany.
  - C. The advanced satellites are revising their economic plans along the same lines as the USSR--with emphasis on chemicals and on quality production.
    1. This raises the possibility of new collisions between Soviet and satellite plans. The USSR, for instance, plans to obtain one Billion rubles worth of chemical equipment from its satellites, but those same satellites probably have their own plans counting on domestic use of that same equipment.

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THE ECONOMY OF COMMUNIST CHINA

- I. The internal scene in Communist China today is a grim one.
  - A. Recovery from the recent years of economic disaster has been very slow, and the small gains have been matched by growing problems.
  - B. The stagnant Chinese economy is not able to feed and clothe the population as well today as it did in the 1950's.
  - C. In the absence of any prospect for substantial production increases over the next few years, the Chinese are showing concern over the continuing population growth. They are making a serious effort to develop a birth control program.
- II. The grain harvest in 1963 was only mediocre, mainly because of prolonged drought in the south, and severe flooding in North China.

((Food Production/Population Chart))

- A. We estimate that 175 to 180 million tons of grain were produced in 1963. This compares with a harvest of 180 million tons in 1957, which was an average year.
- B. The disparity is more drastic than it sounds. The population, now 718 million, has increased at a rate of about 13 million per year. Thus China will have a slightly smaller harvest, but some 77 million more people to feed, than in 1957.
- C. Food imports will be needed again in 1964 to maintain present levels of consumption, which are already

10 to 15 percent below 1957 consumption levels.



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- D. The regime's higher priority for agriculture is having little immediate impact. Any effective program for agricultural recovery will require significant investment and technical improvements over a long period.

((Chart on Industrial Production))

III. Industry in China has given recent Western visitors an impression of great technical difficulties, wasted manpower, and much idle capacity.

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- A. [REDACTED] most industry is producing at little better than 1957 levels.
- B. As the chart shows, the "Great Leap Forward" almost doubled Chinese industrial production in three years, but the entire gain was lost in the abrupt collapse of the program. Since then, the index has barely inched up a few points.
- C. Any further development of modern complex industries is going to call for imports of both equipment and technology.

((Chart on Foreign Trade))

IV. Peiping's trade with the Soviet bloc dropped more than 65 percent between 1959 and 1962, from \$2.9 Billion to \$1.1 Billion in 1962, and last year it was down to about \$900 million.

- A. For the past three years, Communist China's trade with the free world has been greater than its trade with the rest of the Communist orbit.

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- B. Most of the trade with the free world consists of food imports by China. The Chinese have been shopping in Europe and Japan, but have made few purchases other than food grains.
- C. The reluctance to buy reflects both the tight foreign exchange position and Peiping's indecision on long-range planning goals.
- D. The Chinese will have more money for such shopping when they complete their debt repayments to the Soviet Union in 1965. In 1962, for instance, these repayments amounted to \$270 million in exports, some of which will eventually be available for sale in the Free World.
- V. There has been little recent evidence of any long-range planning.
  - A. The Third Five-Year Plan (1963-67) has been largely ignored in Peiping's pronouncements.
  - B. Three factors complicate planning decisions:
    - 1) Unquestioned priority is given to industries supporting advanced weapons programs;
    - 2) There is no relief in sight for the pressure of the growing population on food supplies; and
    - 3) Peiping can't seem to cope with the difficulty of reviving a stagnant economy.
  - C. About the only thing Peiping can plan on for certain is the need for continuing grain imports for many years. A recurrence of the 1960-1961 food crisis, when rations dropped close to starvation levels, is entirely possible.

VI. Economic distress has been the cause of widespread political unrest and disaffection.

- A. China's peasants are sullen and apathetic.
- B. Those living in the cities seem to be better off than the peasants, but unemployment is a serious problem.
- C. Young people in particular are disappointed at the lack of job and study opportunities.
- D. Discontent, however, has not reached a point which would pose a problem for the security forces of the regime. The population is too apathetic to engage in anything like mass resistance.